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IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA
IN AND FOR THE COUNTY OF SAN FRANCISCO
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LESLIE WHITELEY, et al.,
Plaintiffs,
vs. Case No. 303184
RAYBESTOS-MANHATTAN, INC.,
et al.,
Defendants.
/

DEPOSITION OF THOMAS RICHARD ADAMS
WEDNESDAY, MARCH 15, 2000

REPORTED BY:
JO ANN BRUSCELLA, CSR No. 4295

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I N D E X

DEPOSITION OF THOMAS RICHARD ADAMS

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INSTRUCTION NOT TO ANSWER

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BE IT REMEMBERED that, pursuant to Notice of Taking Deposition, and on Wednesday, March 15, 2000, commencing at the hour of 9:34 a.m. thereof, at 818 Mission Street, 5th Floor, San Francisco, California, before me, JO ANN BRUSCELLA, duly authorized to administer oaths pursuant to Section 2093(b) of the California Code of Civil Procedure, appeared telephonically

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THOMAS RICHARD ADAMS,
called as a witness on behalf of Plaintiffs, and the said witness, being by me first duly sworn, was thereupon examined and testified as hereinafter set forth.

A P P E A R A N C E S

WARTNICK, CHABER, HAROWITZ, SMITH & TIGERMAN, 101 California Street, Suite 2200, San Francisco, California 94111, represented by ROBERT BROWN, Attorney at Law, appeared as counsel on behalf of the Plaintiff.

LAW OFFICES OF HOWARD, RICE, NEMEROVSKI, CANADY, FALK & RABKIN, Three Embarcadero Center, Seventh Floor, San Francisco, California 94111, represented by H. JOSEPH ESCHER, III, Attorney at Law, appeared as co-counsel on behalf of Defendant R.J. Reynolds Tobacco Company.

WOMBLE, CARLYLE, SANDRIDGE & RICE, 1600 One Triad Park, 200 West Second Street, Winston-Salem, North Carolina 27102, represented by NEIL KODSI, Attorney at Law, appeared

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telephonically as co-counsel on behalf of Defendant R.J. Reynolds Tobacco Company.

SHOOK, HARDY & BACON LLP, One Market, Steuart Street Tower, Ninth Floor, San Francisco, California 94105-1310, represented by ANNIE CHUANG, Attorney at Law, appeared telephonically as counsel on behalf of Defendant Philip Morris.

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EXAMINATION BY MR. BROWN

BY MR. BROWN: Q. Mr. Adams, my name is Bob Brown. I am representing the plaintiffs in this Whiteley action. Good morning, sir.

A. Good morning.

Q. Would you please start off by giving us your full name for the record, please?

A. My name is Thomas Richard Adams.

Q. And you are employed by whom?

A. I am employed by the R.J. Reynolds Tobacco Holdings Company.

Q. Are you also employed by any other related Reynolds company?

A. No.

Q. How long have you been employed by the Reynolds -- I'm sorry, Tobacco Holdings?

A. Yes.

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Q. How long have you been employed by that company?

A. Since June of 1999.

Q. Before that, you were employed by whom?

A. Employed by Deloitte and Touche.

Q. So that you have just recently come to the Reynolds family, so to speak; is that right?

A. Yes, that's correct.

Q. At the CPA firm, over the last, roughly, ten years, assuming you were there that long, what were you doing?

A. I was a partner with Deloitte and Touche.

Q. Were you doing audit work that related to Reynolds, among other things?

A. Yes, among other things.

Q. Were you ever in charge of the Reynolds audit?

A. I was in charge of the domestic tobacco company audit from about 1989 through 1998. Excuse me. Through 1997.

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Q. Did you receive a list of documents that were requested for this deposition?
A. No, I have not.
Q. Let me ask you. And I assume -- maybe I shouldn't assume.
Have any materials whatsoever been collected to be turned over to us at this deposition, even though it might
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take a day or two to get out here?
A. I'm not aware of any.
Q. Give me a rundown on what kind of documentation you have looked at in order to be prepared to testify in this deposition.
A. Well, I looked at our annual report and our 10-K.
Q. Would that be it?
A. That's pretty much it.
Q. And the 10-K is '99?
A. Yes.
Q. And the annual report has financial information in it that would, what, be identical to the financial information in the 10-K, or is there a different --
A. Well, it's more limited.
Q. It has a different format?
A. No. I would say it has a similar format, but it's the same type of information.
MR. ESCHER: Mr. Adams, there is someone from Shook, Hardy who wants to conference in on this deposition.
(Discussion off the record.)
BY MR. BROWN: Q. Have you seen the document which designated you as an expert witness?
A. Yes, I have.
Q. And does that accurately reflect -- do you happen to have that in front of you?
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A. No, I don't.
Q. When you reviewed it, did it accurately reflect what the subjects were that you were going to be asked to testify about as an expert witness?
MR. ESCHER: Objection, lack of foundation. He can't know what he is actually going to be asked to do. But what he anticipates, he can answer.
MR. BROWN: Go ahead.
Q. Are you there?
A. I am here.
Q. Do you want me to ask the question again?
A. Please.
Q. All right. Let me give you a little background.
You noticed, didn't you, that in the designation under each expert witness, including yours, is a phrase that begins -- and in your case it began by saying, "Mr. Adams may be called to testify regarding," and then in your case it listed five subjects.
Do you recall that generally?
A. I recall that there were things listed, but I don't recall specifically what was listed.
Q. Do you recall that the five subjects listed accurately reflected the general areas that you were going to be called on to testify concerning?
A. If you have those in front of you, and you could
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read them or summarize them, I could answer. I just don't recall what they said.
Q. Sure. I would be glad to.

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No. 1 is the financial status of the company. No. 2, the economic activities engaged in by the corporation on a national and local basis. No. 3, the profitability, or lack thereof, of the company.

No. 4, the direct impact that industry changes, corporate changes, market changes, structural changes, and some legal developments have had on the financial position of the company. And 5, the impact which serial punitive damage awards will likely have on the company.

Were you able to take some notes to kind of stay up to those five?

A. Yes.

Q. Do those five accurately and exclusively reflect the general areas in which you are going to testify?

A. Yes.

Q. Let me just go right to it here and ask you first to tell me what your opinions are going to be with respect to the first one, which is the financial status of the company.

A. I don't think I understand your question. I mean --

Q. Well, we have had listed for us those five, and the first one is the financial status of the company.

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What are the opinions that you are prepared to give, and I am talking about the general opinions now, no detail or backup opinion, but the general opinions you are prepared to give, which reflect the financial status of the company?

A. I mean, I can speak to the financial condition of the company, but my understanding was that you were going to ask me questions about that, and to which I would respond.

Q. Here's the way it works. A party presenting an expert lists the general subjects on which that expert is going to be presented. The expert is required to be prepared to provide his opinions that he is going to give on those subjects at the time of the deposition, which is now.

So what I am asking you is, what opinions do you -- are you prepared to give in the trial of this action on the financial status of the company?

A. I am prepared to talk about the financial statements of the company, and disclosures that are included as part of our financial statements.

MR. BROWN: Well, let me go off the record a minute.

(Discussion off the record.)

BY MR. BROWN: Q. We have been given an off-the-record description of what might work here in order to accomplish something meaningful in the deposition.

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Were you able to hear it?

A. Yes, I was.

Q. Now, I'm not asking you to give me every opinion you are going to -- you expect to give with respect to the financial status of the company. Obviously that's an overbroad and very general question.

What I would like you to tell me is the significant opinions that you believe you will be -- that you are prepared to give with respect to the status of the company. And I am talking very generally now.

MR. ESCHER: I object. It's vague. But go ahead and try to answer the question.

BY MR. BROWN: Q. You don't have to give me detail on it. Just list for me what are the general

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significant areas of the financial status you are prepared to testify about.
A. Well, in general, I could speak to the balance sheet, to the balance sheet of the company, and to the income statement, and to those types of things. But I would like some guidance from you as to at what particular date you would like me to speak as of, and --
Q. Well, let's -- I'm sorry.
A. I'm looking at a long history, and I am sure you're not concerned with what happened in 1900.
Q. Probably not.

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A. If you could give me a framework with which to work in, I would be happy to describe the financial condition of the company and provide you with my opinions concerning those.
Q. I assume you have met with counsel for R.J. Reynolds and that they have advised you on generally what you are going to be asked; correct?
A. Not specifically with respect to this matter, no.
MR. ESCHER: Bob, could I suggest a way which I think would be helpful?
You don't have to take me up on it. Maybe you could ask him specific questions about the balance sheet for the year ended December 31st, 1999, and in particular, his views about the net worth of the company.
MR. BROWN: I have a lot of specific questions. The first thing I wanted to find out is what these five subjects indicate, or what are indicated by these five subjects.
I mean, I don't think that, given that you are from out of state, and that you don't understand what our legal requirements are, that you are doing anything here on purpose. There does have to be a meaningful deposition with respect to each of these subjects.
I have some specific questions to ask, but I would like to know -- I don't want to know particularly what I am

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going to ask you. I want to know what you are going to be able to tell us.
You are coming in to testify at trial. And I guess, from your answers up to now, you have not been prepared to testify in this trial by some counsel; is that correct?
A. I am prepared to testify about the financial condition and the financial statements of R.J. Reynolds, the holding company, which we publish to the outside, to the Securities and Exchange Commission. And I am prepared to do that.
Q. When you say "R.J. Reynolds," we are talking about your present employer; correct?
A. Yes, Tobacco Holdings, that's correct.
Q. When I use R.J.R., we are talking about what sounds like back in North Carolina you refer to as Tobacco Holdings; right?
MR. ESCHER: Objection. I actually think that's potentially confusing and not necessarily accurate. I think it would be better for the record to refer to R.J. Reynolds Tobacco Holdings and R.J. Reynolds Tobacco Company because they are different entities.
MR. BROWN: Let's call them Holdings and Company, then.
Q. Will you understand what I'm talking about when I

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say "Holdings" and "Company"?
A. Right. By "Holdings," you mean the holding company, which is required to report under the SEC. And by "Company," I believe you mean the domestic tobacco company.
Q. That's right, and you are employed by Holdings.
A. That's correct.
Q. I guess --
A. Excuse me, Mr. Brown. I am an officer of both corporations.
Q. You anticipated my question.
What is the office you hold in each of those companies?
A. I am the senior vice-president and controller of both companies.
Q. Are the officers in both companies, at the top level, the same, the same people?
A. I believe in general that they are, but I would have to go back and look at the corporate minutes.
Q. CEO the same?
A. Yes, I believe it is.
Q. Board of directors the same?
A. No, I don't believe it is.
Q. The holding company is the parent of the company?
A. Yes. Holdings is the parent of the company.
Q. Are you going to be testifying about the financial
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condition of the holding company?
A. I can.
Q. Well, have you been told that's what you're going to do?
I am asking you, when you say "the financial status of the company," what company does that refer to?
A. I can talk actually to both, both Holdings and the company.
Q. I appreciate that because you're in both companies.
What I am asking you is, what company is referred to in No. 1, the financial status of the company?
MR. ESCHER: He didn't write --
THE WITNESS: Both, I believe.
BY MR. BROWN: Q. Well, give me your general overview.
What is the current status of the holding company?
A. The current status, the current financial status of the holding company?
Q. Right. What's the state of the union, so to speak?
A. Can I -- I don't have any documents in front of me. It might be easier if I would have a document in front of me.
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MR. ESCHER: Why don't you get the 10-K in front of you. Is it easily available?
THE WITNESS: Yeah. I can walk down the hall and get one.
MR. BROWN: Why don't you do that. We will wait for you.
(There was a brief recess.)
BY MR. BROWN: Q. Now you have got the 10-K. I just wanted you to give us a general opinion about the financial strength or weaknesses of the company.

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A. Okay. To let you know, the financial condition of the company, I think you have to look at several different measures, and frankly, probably several different financial statements. And by "financial statements," I mean those like a balance sheet and an income statement.

What I would like to speak to, first of all, is our balance sheet.

Mr. Brown, have you seen our 10-K?

Q. Yes. I have seen it very generally.

A. Well, what I'm going to talk about is the financial statements of Holdings as of December 31st, 1999. These statements were filed with the Securities and Exchange Commission last week on, I believe, March 8th or thereabouts.

In those statements we show assets of about

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fourteen billion dollars.

Q. I'm sorry.

A. And the stockholders' equity --

Q. Let me interrupt you. I missed something. What was the fourteen million -- or billion. I'm sorry.

A. Total assets. And then we have stockholders' equity of about seven billion dollars. Okay?

Q. All right.

A. What I want to point out is what's contained in the assets, some of the more significant items. Three billion dollars of valuation that's ascribed to trademarks, and about seven and a half billion dollars that's ascribed to goodwill. Then there is the normal current assets and current liabilities.

Those are two of the more significant elements of the financial statements.

Q. What are the current liabilities?

A. The total current liabilities are three billion and sixty-eight million.

Q. I think you were answering a question, and I may have interrupted the flow.

A. That's fine.

Q. Well, what is your general opinion as to the current financial status?

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You have told me what some of the assets and some of the liabilities are.

But given what you have told me, and maybe what you haven't told me, what is your opinion as to the general financial strength or weakness of this company?

A. In comparison to the company in prior years, our financial condition is somewhat better, and I would say that that's largely because of a reduction in debt.

As you may know, back in 1989 this company went through a leveraged buy-out. At that time, and I will give you a little bit of history, Mr. Brown, the company, it was known as R.J.R. Nabisco. And it included the Nabisco Foods group, the domestic tobacco company, the international tobacco company, as well as DelMonte Foods, which is the fresh foods group.

And in 1989 the company went into play, and the management at that time tried to buy the company in a leveraged buy-out. It attracted quite a bit of attention.

The ultimate acquirer was a company or an organization by the name of Kohlberg, Kravitz and Roberts, or KKR. They ended up paying approximately twenty-nine billion

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dollars for this company in 1989, which was substantially more than its book value.

The reason I am pointing these things out is that there is a number of carry-over issues that are in our

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current financial statement that are grounded back in 1989.

Q. Okay.

A. And the two most notable ones are the trademarks and the goodwill. Okay?

Q. Okay.

A. In connection with this twenty-nine-billion-dollar acquisition in 1989, KKR did not have very much equity in the business at that time, and they actually borrowed, I don't know, I think it was probably around twenty-six or twenty-seven billion dollars to finance their purchase of all the stock of R.J.R. Nabisco.

And towards the end of 1989, I think they -- the ending debt balance that they had was about twenty-five billion dollars. There were huge, huge amounts of debts, debts that this company had never seen prior to that period.

So the period from 1989 -- I don't know. For about the next five or six years the corporate part of the company, which was actually headquartered in New York, they spent a lot of time selling off companies, including DelMonte foods, and some confectionery businesses of Nabisco, and various other companies, to generate cash to pay down debt.

So they were -- they were most concerned with paying down the debt because it was -- at the time of the transaction, it was the largest corporate transaction that

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had occurred.

So it was -- paying down the debt was most important to the business for lots of reasons, but principally because the interest rates at that time were so huge the cost of paying the interest in scheduled debt payments were enormous and were impacting the business.

Q. During this period of time, were you involved in the auditing of the company?

A. I was.

Q. Go ahead.

A. As I mentioned before, I was involved in the audits of the domestic tobacco company from 1989 through 1988. I was also involved -- there was a division down here called Planters-Lifesavers. It was Planters Peanuts and the Lifesavers Candy Group. I worked on that account from 1989 through -- I think it was about 1992 or 1993.

And I was also involved in the tobacco international business, because that was headquartered here at the time. I was involved in that from -- as the lead client service partner, from about 1992 or three up until it was sold in 1999.

Q. All right.

A. Okay?

Q. Let me ask you a clarification question. I think I am beginning to understand the structure here a little

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bit.

What you referred to as the domestic tobacco company, that's the company that sells the tobacco products only in the United States?

A. Yes, that's correct.

Q. And that is the company that has the name R.J.

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Reynolds Tobacco Company, or Tobacco Corporation. I'm not sure.

Is that correct?

A. Yeah, that's fair.

Q. The parent of that company is the one that's called -- it was formed, I guess, last June, and that's called the holding company.

A. Right. Yes, that's right.

Q. You and -- you and many of the officers are -- hold the same office in both corporations?

A. Yeah, there are some. I think there are some people that are with the domestic company that are on Holdings boards and -- excuse me, Holdings offices and maybe vice versa.

Q. Are you going to render the opinion that the company has any significant financial weaknesses?

A. I mean, I think there are some weaknesses in this business, and I think that those are reflected in the marketplace and in our continuing business.

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Actually, I was going to get to that after I described the balance sheet and kind of the history of the company. I was going to talk about what I perceive to be the weaknesses in the business and the concerns that I would have beginning in 1998, after the settlement agreement, and the type of impact that that has had on our business to date, and what I believe the impact might be in the future.

Q. All right. That's fair. Go right ahead.

A. As I mentioned to you, I will get to the income statement in a second. I want to kind of frame to you a couple of other events that occurred. And that was in 1997, as a result of a number of state actions against the tobacco industry, the company, and others in the industry.

Not all others, but a number of the Big -- I guess the Big Four tobacco companies entered into agreements, settlement agreements, with the State of Mississippi, Texas and Florida. And that occurred in 1997. And the financial impact of that to earnings, in 1997, was about three hundred fifty-nine million dollars worth of expenses.

Q. That was in 1997?

A. That's correct.

Q. Did you say million?

A. Million.

Q. Right.

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A. And then in 1998, in -- I believe it was in March, there was a settlement with the State of Minnesota. And then ultimately in November of 1998 there was what is known as the Master Settlement Agreement, which was a settlement agreement with the other forty-six states, Puerto Rico, and some of the Commonwealth territories.

And the impact of that I believe was about a 4. -- a 1.4 billion dollar expense to R.J.R.

Q. That was to be over the entire length of the settlement or in one year?

A. That was in one year.

Q. That was --

A. There are provisions, and I will speak to those shortly, about the amount of our payments on an annual basis.

Q. '98 was the 1.4 billion actual payment?

A. Expense. Some of it was paid that year. Some of

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it was paid in 1999.
Q. All paid by now, though.
A. Substantially all of it.
Q. Let me backtrack a little bit.
So the settlements we are talking about are the Mississippi, Texas and Florida settlements.
That was one settlement?
A. Three separate settlements in 1997.

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Q. Then there was the Minnesota settlement, and that was '98.
A. Yes.
Q. Then there was the MSA, which was with the other forty-six states.
A. And Puerto Rico and the territories.
Q. Right.
A. So that occurred towards the end -- the Master Settlement Agreement, which was the largest portion of that, occurred towards the end of 1998. Actually, in November of 1998.
And at that point, because of what we perceived to be our -- the decline in the number of cigarettes that we would sell, we actually wrote down and substantially closed one of our plants. So that impacted the business as well.
Q. That was in what year?
A. 1998. Yes, it was in 1998. So that gets us to the end of 1998.
In 1999, the corporate parent, who was then R.J.R. Nabisco, decided they would sell the international business and separate the food business from the domestic tobacco business. That was accomplished in May of 1999.
The international business was sold to Japan Tobacco for approximately eight billion dollars. We paid down -- excuse me. We paid slightly more than two billion

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dollars in taxes, both federal and state, on that transaction. And used the rest of that -- the balance of that, which is approximately six billion dollars, to pay down debt.
This was some of that debt from the KKR buy-out, which gets us to kind of the debt levels that we have today.
Q. And your short-term debt is what?
A. At the end of 1999, it's three hundred eighty-seven million dollars.
Q. And long term?
A. One billion six hundred fifty-three million.
Q. Okay. I don't think you are through with your description of the status. Go ahead.
A. Okay. No. Now -- again, I'm talking about Holdings Company. These are the statements that you would have reviewed on our 10-K. Okay?
Q. Go ahead.
A. Mr. Brown?
Q. Yes. That's fine.
A. Now I would like to talk about the income statement. The balance sheet is just a picture in time. It's as of December 31st, and it captures information just at that time.
The income statement, in contrast, captures information during a period of time. And what I am about to

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speak to is the period of time from January 1st, 1999, to December 31st, 1999. Okay?

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Q. Sure. Go ahead.
A. Okay. In 1999 our income statement showed seven and a half billion dollars worth of sales. That would be the sales of our product. And then we take out costs and expenses.

I would point out that in our costs and expenses for our -- the tobacco settlement -- I talked about financial settlement agreements in 1998, and the amount of money we paid there. We have ongoing payments as well.

Q. Right.
A. Okay? And those ongoing payments this year were approximately 2.2 billion dollars.
Q. Are you talking about 2000 now?
A. No. In 1999.
Q. You said this year.
A. I meant in reference to what I was speaking to.
Q. All right.
A. As a practical matter, there will be probably at least two billion two in 2000. These payments go on indefinitely. Actually, in perpetuity. We paid these up-front payments of the billion four. Now we have annual payments to make to all the states of at least 2.2 billion pretty much forever.

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Q. That's subject, as I understand it, to your sales levels; correct?
A. It is. It is subject to adjustments. I would tell you, in contrast to the 2.2 billion, those adjustments are relatively natural.
Q. Are the sale adjustments tied to dollars or to unit sales?
A. Both, I believe.
Q. Go ahead.
A. Going down the income statement, moving from net sales down through to net income, our net income from continuing operations was about a -- it was a hundred ninety-five million dollars in 1999.
Q. All right.
A. And I think if you were to factor out some of these up-front payments, you would actually see that our income from our continuing operations has actually gone down.

And the reason that I would say that is, to give you a pretty comprehensive analysis to get there, the number of cigarettes that were sold in 1999 for the total industry was down about nine percent from levels in 1998, and our actual sales of cigarettes, the unit sales, now, Mr. Brown, were down thirteen percent.

So we believe that the increased pricing that was

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a part of the Master Settlement Agreement has damaged us because the people that smoke our product with either switching to cheaper cigarettes or less expensive cigarettes, and/or just quitting.

In addition to this, in addition to the payments that were required under the Master Settlement Agreement, there have been advertising restrictions and other restrictions placed on the industry, in terms of its ability to promote its product.

We believe that compared to 1998, we are significantly disadvantaged in our ability to sell our product. And I think that that's been reflected in the lower volumes of cigarettes that was sold in 1999.

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Q. Let me ask some questions about that.
I think you just said that because of MSA restrictions on advertising, your ability to sell cigarettes has been diminished?
A. Well, no. I think what -- there are restrictions on -- there is no longer any outdoor advertising, and there is also restrictions on the numbers of products that you can sponsor, and those types of things, and other promotional types of activities.
I think that that has an impact. I can't quantify to you what that impact is, but I do believe it has an impact in our ability to communicate with our adult smokers.

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Q. What's the other promotional activities you're talking about, in general?
A. There is lots of them. I don't think we can use any cigarette brand names on caps and T-shirts, and things like that. The agreement is actually very voluminous, and I don't have one handy or sitting nearby that I could go through all those with you.
Q. I understand. I want to be sure I got everything. You told us about the MSA impact on unit sales, which would be the price increase, and the advertising you have explained.
Anything else?
A. There is probably other things. I just can't think of them right now.
I would point out to you that when the Master Settlement Agreement was signed, shortly thereafter the price of cigarettes actually increased dramatically to fund those payments. And it increased I believe by approximately forty-five cents a pack.
Q. Is that nationwide?
A. Yes. And that, I believe, in conjunction with some of these other -- that probably is the biggest single reason we had a drop in volume.
Q. When was the drop in volume?
A. In 1990 -- well, volume has been dropping, I don't

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know, probably for the last four or five years at maybe two or three percent a year. And then, as I stated earlier, in 1999 it dropped to about nine percent.
Q. Okay. What -- I'm sorry.
A. I believe the price of cigarettes significantly affects the purchasing of cigarettes.
Q. I think you said nine percent in '99.
Hadn't you before that said that that was the industry drop, and that your R.J.R. drop was thirteen percent?
A. That's correct.
Q. So that's industry.
A. Industry is nine percent. We were thirteen percent. And I think I said two or three or four percent per year. That's for the industry.
Q. What was yours?
A. It was more than that. Our market share has been declining over the last -- actually, probably the last five or ten years. Maybe even longer than that.
Q. Give me, in general, the amount of that decline over five years.
Five years ago where were you and where are you today?
A. I think today we are around twenty-four percent.

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Q. And five years ago you were --
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A. Slightly lower than that. And four or five years ago we may have been at -- I just don't recall. It may have been somewhere between thirty and twenty-seven percent.
Q. Would you give me this? Would you give me your dollar sales volume for '97?
I think that's on your 10-K; isn't it?
A. For '97?
Q. Yes.
A. It is. It was five billion and forty-four million.
Q. And '98?
A. Five billion seven hundred sixteen million.
Q. And '99?
A. Seven billion five hundred sixty-seven million.
Q. So I guess what you're saying is, unit's down, revenue from sales up. But for the reasons you have explained, you feel the company has suffered some damage.
A. Yes. And -- well, I mean -- yes, because of the continuing decline in volume.
Q. In unit volume.
A. That's correct.
Q. Has the company done any forecasting on its ability, over the next five years, to increasing or raising prices?
Maybe I should combine that with the company.
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Does the MSA restrict you in the next five years from raising prices?
MR. ESCHER: Objection, lack of foundation.
THE WITNESS: It doesn't -- I don't think it restricts us in increasing our prices.
BY MR. BROWN: Q. It does not?
A. I don't believe so.
Q. Have you done any forecasting, at the holding company or at the domestic company, in terms of your ability to increase prices over the next five years?
A. We have run some forecasts. Yes, we have.
Q. In general has your forecast indicated that you have room to raise your prices?
A. A lot of that is dictated by what competition does, and we are only actually a small part of this market.
Q. What I am asking is, what does your forecast show?
I appreciate there is a lot of complicated factors that you could go on forever on. You would probably lose me pretty quick.
In terms of the bottom-line forecast, does your forecast indicate you probably will be able to raise prices over the next five years?
A. I don't think that we determined that we can probably increase our prices. Every time the price goes up,
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unit volume goes down.
Q. You have a sales forecast for the year 2000, in terms of dollars?
A. Yes, we do. But I don't have that with me.
Q. Is it higher than seven million?
A. I believe it is, and I believe it is just because there was a price increase that was taken in January, most of which I believe is being -- well, there was one, and it is slightly higher.

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Q. I think, again, I inserted some questions while you were describing your opinion about the status of the company. So go ahead and continue.
A. Mr. Brown, you keep asking me about the company. I would point out to you that what I keep describing is Holdings, which includes not only the company, but our Puerto Rican subsidiary and some other companies as well.
Q. Okay. That's fine. I appreciate that.
A. All right.
Q. Go ahead and continue.
A. I think that our ability to continue in business, you know, it's a concern.
Frankly, as I stated before, as the -- I think we have an older -- in general, an older group of smokers who tend to be more price-sensitive, and that the Master Settlement Agreement, as I mentioned earlier, the Big Four

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tobacco companies, as they are generally known, were all parties to that agreement.
Q. Maybe you should identify the Big Four for us.
A. That would be Reynolds and Philip Morris and Lorillard and Brown and Williamson.
Q. You say you have -- I'm not sure. Let me withdraw that.
The corporation, speaking as the corporation as a person, has concerns about the ability to continue in business?
A. No. I said we have concerns about our ability to grow our business.
Q. So the concern's about growth, not about the ability to stay in business.
A. Well, I mean, you have those concerns, too, depending upon, you know, what happens with litigation and any government action.
You know, as you know, the government has been observing that they want to take control over the industry through the FDA.
There is numerous cases, legal cases, smoking and health-related, you know, class-action suits. They are facing not only this company, but the industry. So there is some concern.
Q. Would it be fair to say that the concerns about

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the ability to continue in business are exclusively limited to the -- what the government might do?
Specifically the FDA litigation, and that includes your class actions.
MR. ESCHER: Objection, lack of foundation to respond to this question. Go ahead and try and answer.
THE WITNESS: No, I would not say that. There is competitive issues as well.
MR. BROWN: All right.
THE WITNESS: As I was getting ready to say, or as I stated earlier, the only -- only a few companies, and it happens to be some of the larger companies, were a party to the Master Settlement Agreement.
There has been actually an increase in the number of cigarette companies that are in business that started selling cigarettes in the last three or four years. They are not a party to the Master Settlement Agreement, and therefore they have a price advantage in the marketplace.
BY MR. BROWN: Q. Because they are charging roughly the same price, but they are not paying out MSA

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payments.
A. No, sir. They are actually selling substantially lower than that because they don't have to make the MSA payments. So I guess what I'm saying is, they can -- they have a price advantage because of the Master Settlement

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Agreement.
Q. Let me ask you to do this. Just from the standpoint of the financial condition of the company -- and I am talking about it the same way you are. The company, meaning all of your subsidiary companies, including domestic tobacco.
Just from the standpoint of the balance sheet, the income, and the financial considerations, is there anything within those documents or in that area that would indicate a concern for staying in business?
A. Yeah. The one thing we disclosed in the financial statements, the litigation.
Q. Any other reason to be concerned about staying in business, besides the litigation?
A. Not that's indicated in the financial statements, but the financial statements look kind of narrowly and very shortly. They look one year out.
Q. So that I understand, this narrow issue or narrow concern --
A. It's not a narrow concern or a narrow issue. It's a narrow time frame.
Q. Explain that.
A. Well, as I mentioned, the disclosures that we have with respect to litigation. And if you look at our 10-K, we have, I don't know, ten or eleven pages worth of litigation

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disclosure which describes the types of cases that we have, the numbers of cases, what we believe our census are.
We also state that if -- you know, in the event that any of these things are resolved in a fashion that's not favorable to the company, it could have a material adverse effect on the business. We are not able to estimate what that is at this time.
I am paraphrasing the language in here because I haven't looked at that particular page. So from that standpoint, very narrow in time, looking out one year, these things that are said -- that this occurred December 31st, 1999, could have a significant impact on our business. Okay?
Q. Are you saying a significant impact -- significant enough so that R.J.R. would have to go out of business?
MR. ESCHER: Objection, vague as to the term "have to go out of business."
MR. BROWN: Let me make it more specific.
Q. Does that concern rise to a level where the company has considered bankruptcy?
MR. ESCHER: Objection, lack of foundation.
MR. BROWN: I am only asking about what you know.
MR. ESCHER: I want to caution you not to disclose the contents of any confidential attorney-client communication.

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THE WITNESS: The bankruptcy situation, Mr. Brown, I would prefer not to discuss because that's confidential.
MR. BROWN: Well, I need to get some handle on -- and definition of when you describe concerns.
I appreciate that you have got some confidential

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concerns there, but I would like to know if the litigation has raised serious discussions about the potential of the company going into a Chapter 11 because of the litigation.

MR. ESCHER: The same objection, and I am going to caution the witness not to disclose the contents of any confidential attorney-client communication.

MR. BROWN: I appreciate we are in a delicate area here, but you understand I --

MR. KODSI: I'm having trouble hearing your objection. Are you cautioning the witness not to answer any confidential attorney-client communications and/or communications within the company that he might deem confidential?

I didn't hear the objection.

MR. ESCHER: No. I think the answer is the former. But it would include the latter if the latter includes the former, which is to say that anything that involves a confidential attorney-client communication, whether communicated directly or indirectly to him, is something that he shouldn't disclose in his answer.

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MR. BROWN: I am not interested in any conversations or messages back and forth between this witness and lawyers or his knowledge of any communications between lawyers and the company. I am not inquiring into that.

I am inquiring as to a fact, the existence of a fact or not, and that is, whether or not the company is seriously considering bankruptcy because of litigation.

MR. ESCHER: I'm going to instruct the witness not to answer that question if that fact would disclose the contents of a confidential attorney-client communication.

I hope the witness understands that objection.

THE WITNESS: I understand that, and I am not going to answer that question.

BY MR. BROWN: Q. Let me ask it slightly different, with the explanation that you may have heard that the -- this is a hypothetical, of course.

You may have heard through lawyers, which would be confidential under the attorney-client privilege, that the company is considering bankruptcy because of litigation. But outside of the attorney-client privilege and other contexts in discussions between only executives of the company who may have heard the same thing.

So let me go to the latter.

Have you heard any discussions between the company executives, no lawyers present, in which a serious

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consideration of bankruptcy resulting from -- as a possible result of this litigation that's going on has been discussed?

MR. ESCHER: I'm going to instruct the witness not to answer that question unless you are completely confident that any such conversation would not have repeated any confidential communication between an attorney and the client, R.J. Reynolds Tobacco Company.

Unless you can be sure that that's the case, I am going to instruct you not to answer that question.

THE WITNESS: I am not sure whether that is the case, and I am not going to answer that question.

MR. BROWN: We can move ahead. Let me ask you some specific questions about litigation.

Q. Has the company, any of the companies, ever paid a punitive damage award?

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A. No, not to my knowledge.
Q. I am aware of two punitive damage awards that exist. One is in the Hennley case tried in San Francisco about a year ago, and one is in I think in Portland, Oregon, tried about the same time. These are pending punitive damage awards. They are on appeal.
You are aware of those; are you?
A. Yeah, I am aware of those. I guess I didn't realize that my company was a party in those cases.

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Q. I'm sorry. You're not. I was not thinking clearly. That is Philip Morris. Let me skip beyond that.
Are there any pending punitive damage awards against the R.J.R. companies?
A. With regard to --
Q. Litigation.
A. Mr. Brown?
Q. Yes, with regard to cigarette litigation.
A. I'm not aware of any.
Excuse me. Did you say pending?
All these cases or many of the cases that are listed in our disclosure are requesting compensatory and punitive. I believe it's being asked, but I don't think we are in a situation where any judgment has been rendered.
Q. That's what I am asking, is the latter part.
To make it clear, there are no pending punitive damage awards against R.J.R. or any R.J.R. company resulting from cigarette litigation; is that correct?
A. Not to my knowledge.
Q. Has there been any forecasts of the amount of punitive damage awards you might expect in the next year?
MR. ESCHER: Once again, I am going to caution you not to disclose the contents of any confidential attorney-client communication. If you can answer that question without doing that, do so.

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MR. BROWN: I am not asking what the forecast said. I am saying are there --
MR. ESCHER: The fact that there is such a forecast would, in itself, be a confidential attorney-client communication. That is the reason I am cautioning him not to answer that question unless he is confident that, if such a thing exists, it wasn't an attorney-client communication.
Do you understand the question?
THE WITNESS: I do.
MR. ESCHER: Can you answer the question?
THE WITNESS: No. I don't think I can respond to that.
BY MR. BROWN: Q. Let me ask you this.
Are there any pending judgments against R.J.R. from cigarette litigation that are other than punitive damage awards?
A. I don't know the answer to that. Would you repeat that?
Q. Sure. I am asking whether you are aware of any awards of damages against R.J.R. from cigarette litigation, which are not punitive damage awards.
A. Today.
Q. Today, yes.
A. I don't believe that I am aware of any. I am aware that there is a case that is going on in Florida right

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now, which is in the stages of -- I think it's compensatory

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damages.
Q. Is that Carter?
A. No. That's Engel.
Q. All right.
A. I don't know what the status of that is. I'm not really aware of any others.
Q. All right. So let me try to see if I can ask some questions to wrap it up.
In terms of materiality that concern matters on the balance sheet, litigation would be the only one?
A. No. There's other things that can occur.
Q. I'm talking about what's stated on the balance sheets or in the income statements. Forget that. In the 10-K.
The 10-K doesn't express any material event or future event which would significantly affect the company, other than litigation; is that correct?
MR. ESCHER: Well, objection. I think the document speaks for itself.
Go ahead and answer, if you can.
THE WITNESS: The litigation section does speak to potential material unfavorable outcomes, and -- but there is other things in here that could affect it as well, you know, such as our bank -- our loan agreement with banks, and

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potential covenant violations.
There's -- all of that stuff is included in the 10-K.
BY MR. BROWN: Q. Does the 10-K express any event that has occurred or is likely to occur which it expresses is a material problem in terms of the future financial strength of the company, other than litigation?
MR. ESCHER: Same objection.
THE WITNESS: Actually, I think in our -- let me look. There is a section in the front part of the 10-K that speaks to the business. And while it is populated with lots of stuff on litigation, it talks about competition, and it talks about how our market share -- here are the numbers you asked me before, Mr. Brown, about our market share.
In 1999 our market share was 24.12 percent. In 1998 it was 25.17 percent, and in 1997 it was 25.41 percent.
So I would say from a risk standpoint we are describing in the competition section, the front part of the 10-K, you know, what's occurring to our market share. And we actually lay out the market share of Philip Morris in here as well, because they are the major competitor in this business. While our market share has been declining, theirs has been increasing.
I know we also talk about, you know, other competitive issues in here. So I don't think it's fair to

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say that litigation is the only thing that is somewhat forward-looking here. I think we kind of lay out the situation of our company in this business. There are significant risks going forward.
Q. I wasn't suggesting that litigation is the only one. I am trying to find out if there were more than litigation.
You have listed litigation and the competition, and you have described why the competition problem is there, I think.
A. Right. And the other thing is the Master Settlement Agreement and the ongoing payments. We have

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payments we have to make as a result of that.
Q. Would that be the three? MSA, competition, which are somewhat related, and litigation?
A. And legislation at the federal level, whether it's increased excise taxes or regulation. This is not an industry without its challenges.
Q. Just maybe you could sum up for me, how would you describe, in a brief statement, the financial strength of R.J.R. companies at this point?
A. Well, I think in terms of financial conditions, certainly our debt levels are lower today than they have been in the past ten years. But the business itself is -- the sales of our product, the unit sales of our product, are

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declining, and actually had declined substantially in 1999.
And I think some of that -- we haven't really talked about our stock price. Prior to June 15, this company was part of a larger corporation. And its stock price suffered as a result of the debt that was carried forward on this leveraged buy-out.
But it's like on June 15th our stock -- we became a separate stand-alone company, and our stock that came out of this split-up, the sale of the international business and the spin-off of Nabisco, stock came out of that thirty-two dollars a share. That's the price the public was paying. Today it's roughly half that. I looked shortly before this phone call, and it was somewhat less than seventeen dollars a share.
So, you know, if you look at that, and I was thinking about what the market capitalization of this company is, the market capitalization, Mr. Brown, is just merely the number of shares of stock that we have outstanding multiplied times the share price.
Let's just say for purposes of this discussion it's seventeen dollars, which I think is a little high right now. But seventeen dollars times a hundred billion shares, that would put our market capitalization at about a billion seven. Okay?
If you compare that to where we started this, the

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net worth -- we said our net worth is like seven billion dollars. It's about a 5.3 billion dollar disconnect, which says to me the stock market or the investors are valuing this company substantially less than its net worth.
Q. Let me ask you a couple of questions about what you have said about goodwill.
Do I understand correctly that the goodwill on the books would come from acquisitions?
A. No. Actually -- well, yeah. That's correct. The goodwill that is on our books was as a result of KKR's acquisition. They paid -- I don't know. I forget what the goodwill number was back in 1989. But it was slightly more than ten billion dollars. They paid about ten billion dollars more for this business than historical net book value would have shown.
Q. The goodwill on the holding company balance sheet, now, what did you tell me? It was --
A. The carryover.
Q. How much is it at this point?
A. It's seven billion dollars.
Q. That seven billion came from the company acquiring what?
A. From KKR acquiring the company in 1989.

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Q. That doesn't compute. I don't think I understand that. I thought goodwill came from what the business had

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acquired and starts off being the purchase price; isn't that right?

A. No, that's not right.

Pretty simply, the difference -- the way that goodwill is created is that somebody pays more than the book value of the assets.

Q. That's right.

But what I am hung up on is that the goodwill on this balance sheet now would come, would it not, from this company acquiring some asset that would give it a goodwill number?

A. The seven billion dollars comes from as a result of the 1989 acquisition of R.J.R. Nabisco by KKR.

Q. I guess I don't understand how purchasing -- they purchased the stock; right?

A. Yeah, but they borrowed money within the company to do it. The company actually borrowed the money.

Q. I guess I will ask my own experts, if I can't figure out from your answers what's going on.

What I don't understand is how the purchase of stock by KKR results in a goodwill entry on the R.J.R. balance sheet.

A. KKR acquired the stock of the company, but they used the company itself, R.J.R. Nabisco, to borrow the twenty-nine billion dollars. That's why it's called a

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leveraged buy-out. You leverage the company's assets, and borrow at the bank on the company's books. KKR just ended up with the common stock ownership. It's not like an acquisition.

Q. Let me ask this, then.

What specifically is the asset on the balance sheet for which the seven billion goodwill is applicable?

A. It is the asset.

Q. But it comes from what asset?

A. It comes -- let me back up, and maybe I can explain this to you. Okay?

In 1989, when KKR paid for this company, there were -- let's just say they paid twenty-nine billion dollars for the company. Okay?

Q. All right.

A. And let's say that -- let's just say this occurred the beginning of this year. That way we don't have to deal with any of the amortization issues. If you look at the balance sheet, today our trademarks have a value of three billion dollars. Okay? And our goodwill has a value of seven and a half billion dollars. So that's 10.5 billion. Okay?

Q. All right.

A. Okay. Well, the difference between the twenty-nine billion dollars, that KKR paid, and the ten

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billion dollars worth of these intangible assets is about nineteen billion dollars. Okay?

Q. All right.

A. So what I am saying is that in the scenario where a company had a stated net worth of nineteen billion dollars -- okay?

Q. All right.

A. -- and somebody pays twenty-nine billion dollars

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for it, that they are paying a premium for the company, a premium compared to the -- to it's indicated net worth. And that premium, that ten and a half billion dollars, you have to allocate that to something.

So you go through an allocation process, and the accounting literature that you use to do that is called APV 16. It's Accounting Principles 16, and it talks about restarting a company's books and records by fair-valuing things.

And two of the things that this company fair valued, among other things, was its trademarks, which is the value of its brands, and anything that's left over is known as goodwill. It's basically the excess purchase price that they paid.

Q. Does that get written off?

A. Over forty years, yes.

Q. You selected -- the company selected a forty-year

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write-off?

A. In 1989 it did.

Q. What percentage was coming off every year?

A. One-fortieth every year.

Q. You have had ten years of write-off at 140th?

A. Between the trademarks and goodwill it's about three hundred sixty-six million a year.

Q. I appreciate your trying to explain that.

A. Let me also explain to you that prior to, in fact, this acquisition by KKR, there was no value on here for our trademarks whatsoever. And that's because in an accounting sense, even though you can build up value in a brand, until there is a transaction you can't record any of that value as a trademark.

Q. I understand.

A. It's only when companies are bought and sold that you can record value for trademarks and goodwill.

Q. That's right. You need an event that puts a specific number on it. You can't just make it up.

A. That's right.

Q. Let me go ahead to some other areas that I wanted to ask on this No. 1 thing, and then move forward to the others.

What's your credit rating today?

A. Our credit rating?

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Q. Right.

A. You mean on our debt?

Q. Yeah. How does Moody, for example, rate you?

A. Moody is -- I think I've got that noted here somewhere. I think our S&P rating is BBB minus, and Moody's is BAA2.

Q. All right.

A. I can get back to you on that.

Q. That's close enough.

A. Where we are on the scale is, we are slightly above noninvestment grade, like one or two notches. One notch at one rating agency and two notches at the other.

Q. What lines of credit do you have? Short term.

A. We have a bank credit agreement of about a billion two thirty-five with a syndicate of banks. And we've got -- well, we already spoke to the debt. That's publicly traded debt.

Q. Is R.J.R. buying stock back?

A. We have been, yes.

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Q. What did you buy back in '98?
A. In -- I don't know what we bought. That would have been R.J.R. Nabisco, and I don't know what that was.
Q. How about '99?
A. I think we bought about '77 million back in 1999.
Q. What's going to happen in 2000? What are you

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going to buy back in 2000?
A. We bought back, I think, approximately forty-five million.
Q. That's as of now?
A. Yes. We had a purchase program for a hundred twenty-five million dollars, and we concluded that.
Q. Do you have an earmarked amount of money set aside to buy back stock?
A. Not earmarked, no.
Q. Maybe "earmarked" is the wrong word.
Has the company got a figure in mind that they are going to utilize to buy back stock over the next several years?
A. No.
Q. What is set aside, if anything, to buy back stock the rest of 2000?
MR. ESCHER: Objection, vague as to the term "set aside." Go ahead and answer, if you can.
MR. BROWN: I don't mean you put it in a box and hide it under your bed. You have an amount of money that has been determined will be used to buy back stock over the rest of this year.
MR. ESCHER: Same objection. Go ahead.
THE WITNESS: None of the amount of money that will be used.

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Q. But the amount of money that you are considering using or potentially will use? Something along those lines?
A. I'm sorry, Mr. Brown. Can you repeat that for me, please?
Q. Yes. There is an amount of money that has been determined is potentially to be used to buy back stock throughout the rest of 2000?
A. I don't think that I can answer that because that is confidential.
Q. Let me just ask this. Is there an amount, without telling me the amount, for an additional buy-back this year?
A. I don't think I can answer that either because of confidentiality.
Mr. Brown, you have to understand that any talk of that could affect the capital markets, and I would be in violation of the Securities and Exchange Commission rules.
Q. All right. I will pass on from it.
Sales forecast. What's your sales forecast for 2000?
A. Well, our units are going to be lower, and I would believe that our revenues would be higher because of the price increase. But again, that's confidential, and I think that disclosing that could put us at a competitive disadvantage.
Q. I don't need the number.

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How about over the next five years? What's your -- I don't need the numbers.
Does your forecast indicate that for five years your revenues will be higher, even though your units may be

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going lower?
A. I don't recall what the revenues are. I do know that the number of units are going down. I believe you already asked me what price increases are put into our strategic planning model, and I told you I didn't know what they were. I can't really forecast sales levels because of that.
Q. Is there any corporate plan to reserve, or any corporate plan to do anything in anticipation of punitive damages having to be paid from the cigarette litigation?
MR. ESCHER: Objection, vague, irrelevant, and I instruct you not to answer to the extent that it calls for the disclosure of any confidential attorney-client communication.
BY MR. BROWN: Q. You know what I mean by "reserve." You may not know what I mean because I am not an accountant.
What I am talking about is putting some reserve funds aside to ensure that if punitive damages occur, you would be able to pay them, or doing anything like that. Anything to ensure or at least to help the company deal with

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punitive damage payments.
Has the corporation done anything like that?
MR. ESCHER: Same objections, and in particular I caution the witness not to disclose the content of any attorney-client communication.
THE WITNESS: Frankly, Mr. Brown, I don't understand your question.
MR. BROWN: That's fair.
Q. Has there been any corporate planning to permit the corporation to have the ability to pay off any future payments required for punitive damages?
MR. ESCHER: Same objections and the same cautionary instruction with respect to attorney-client communications.
THE WITNESS: I don't think I can answer that.
MR. BROWN: We are going to take a break here for a second. The court reporter has requested a break.
MR. ESCHER: Are we off the record now?
MR. BROWN: Yes.
(There was a brief recess.)
BY MR. BROWN: Q. I'm going to move now quickly, I hope, through the rest of these five areas that were mentioned. Let's go to No. 3. I will read it again for you so you have in mind. "The economic activities engaged in by the corporation on a national and local basis."

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Can you tell me what is meant by the economic activities, as used in that description of your subject matter?
A. I would presume that means the sales of our product.
Q. What are you going to tell us about that?
A. I think I kind of told you about that. I described the sales of our product and that we have manufacturing facilities here in Winston-Salem that produce our product.
Q. As far as you know, that's the extent of the economic activities engaged in by the corporation?
That's it?
A. I suppose I could talk about not only the domestic U.S. but California, as well.

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MR. BROWN: Joe, do you have any help on that? It sounds specific. You're talking about some economic activity. What is it going to be?
MR. ESCHER: You're asking him the questions. The problem is that the question is at such a high level of generality I'm not sure he knows what level of specificity to respond with.
MR. BROWN: Very general. Very, very general.
THE WITNESS: I believe that I have answered that.

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MR. ESCHER: I think he has answered it at the level of generality that you have asked it.
MR. BROWN: You have already -- in talking about financial status, you have already talked about it.
THE WITNESS: I believe so, in a very general sense. There are cigarettes in all fifty states in the territory.
MR. BROWN: The problem, Joe, is that the phrase itself is so general that, other than to ask what you mean by it, I don't know anywhere to go. Economic activities is a wide field.
What did you guys have in mind when you designated him to talk about economic activities?
THE WITNESS: I can talk about sales and states and those kinds of things. California-specific stuff. I don't have the information in front of me right now, but I could be prepared to do that at some point.
MR. BROWN: The problem is, if you don't know, and I don't know, and maybe Joe doesn't know either, there isn't much I can ask you about, other than to say what are you talking about.
MR. ESCHER: Let me short-circuit this. I think that you have asked questions that would -- and you have received answers that would give you a fair idea of the content of his anticipated testimony on this subject.

00058

MR. BROWN: Okay.
MR. ESCHER: Why don't you go to the next subject.
BY MR. BROWN: Q. The next one reads "the profitable or lack thereof of the company." I think we have touched on that.
The company is profitable today; isn't it?
MR. ESCHER: Objection, vague as to the term "profitable." Go ahead and answer the question.
THE WITNESS: Can you define today, Mr. Brown?
MR. BROWN: Well, the end of '99.
THE WITNESS: The end of '99, as I mentioned earlier, we had earned a hundred ninety-five million dollars from continuing operations, and that was compared to a loss of five hundred nineteen million dollars.
BY MR. BROWN: Q. That's net income before taxes?
A. No. It's after tax.
Q. After tax.
A. Right. In 1999 we had a loss of five hundred nineteen million dollars in 1998, and we had a profit of nineteen million dollars in 1997. Those are all amounts that are appearing on our 10-K.
Q. What was the pretax profit in '99?
A. Five hundred ten million.

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Q. And in '98 you said there was a loss? That's a loss -- you don't mean a loss after taxes.
A. Yes.
Q. A loss after taxes? And it was five hundred and something?
A. Five hundred nineteen million after taxes. It was a six hundred seventy-nine million dollar loss before taxes.
Q. And '97 you said was what?
A. Nineteen million dollars of profit, net income.
Q. That's after?
A. After taxes.
Q. What was it before?
A. Two hundred four million.
Q. What else can you describe to us in terms of profitability?
Do you expect to be profitable in 2000?
MR. ESCHER: Objection, lack of foundation, vague as to the term "profitable."
THE WITNESS: I believe we will have net income in 19 -- excuse me, in 2000.
As I mentioned, the -- and perhaps in future years, but a lot of that is going to be predicated on the amount of our Master Settlement Agreement costs, because that is, frankly, the largest single cost in our -- I believe in our income statement.

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As I mentioned to you, this year -- or in 1999 we paid approximately $2.2 billion, and those numbers escalate. I believe they escalate at about three percent a year in perpetuity.
So the amount of any price increases that we have -- and this is to your earlier question. It's going to be difficult to achieve price increases, in the face of margin increases, to become more profitable. We will, in all probability, have to increase prices to fund some of the increased MSA costs.
Q. In 2000?
A. Yes. Actually, I think part of the increase that was taken this year will cover that.
Q. So the price increase for 2000 for MSA has already taken place.
A. Well, I don't think it's -- it wasn't specifically allocated towards that. We didn't leave that price increase, but that's kind of what it is. For future years there are increases in the MSA payments.
Q. Are you forecasting any period of time in the future in which the company will not be profitable?
A. Not at this point. But we haven't put in any -- there is a lot of sensitivities out there, a lot of events that could occur that may impact our financials in an adverse fashion, such as litigation.

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The one thing I really didn't talk about, in the sale of Japan Tobacco we have agreed to indemnify the Japan Tobacco for certain costs, principally taxes, and in certain litigations.
This was agreed to as of the date of the sale. And any of those events, if they were unfavorable and significant, could materially impact our business.
Q. Do you expect them to be material and significant?
A. I would -- it's possible. I don't know of any right now or we would -- but it's possible.

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Q. The indemnity is with respect to liability for the smoking of the cigarettes that are now being sold by Japan Tobacco?
A. No, sir. It has to do with conditions that existed, at the date of the sale, that relate principally to taxes, and custom taxes, income taxes, VAT. Taxes of that nature that -- where there may be disputes in the various countries, and how the international business conducted itself over the past years.
And there are a few cases that the company -- legal cases that the company has agreed to indemnify Japan Tobacco on as well.
Q. Are those cigarette liability cases or something else?

00062

A. Something else.
Q. Let's go to No. 4, which reads, "The direct impact that industry changes, corporate changes, market changes, structural changes and some legal developments have had on the financial position of the company."
I assume it sounds like it's talking about past tense.
A. Yes.
Q. Let me ask you this. What industry changes have impacted the company?
A. The master settlement agreement dramatically impacted us. We have spoken about that, but that occurred in December of '98. And between -- excuse me, November of '98. Between that time in '99, at the end of '99 our volume dropped thirteen percent, and that is substantial.
Q. Any other industry changes?
A. We sold our international business. From a corporate standpoint, that affects us because to the extent there were growth opportunities overseas and money we could earn from that business, we no longer have that to fall back on.
Q. Any other industry changes?
A. We are only a domestic tobacco company now.
Q. Any other industry changes?
A. Those are the only ones that I can think of.

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Those are the only ones that have occurred. There is much more that are likely to occur.
Q. What are they?
A. Further taxation under excise taxes by the government. Further state excise tax increases. Sales tax increases. Limitations on smoking in bars. You know, other federal provisions. Regulations by the FDA. A number of the things we have spoken about.
Q. The next thing says, "Corporate changes." It sounds like what you have told me so far, with some exceptions, could also be called corporate changes.
Other than what you have already told me, any other corporate changes that have impacted your business?
A. Other than us becoming a much smaller corporation of the old R.J.R. Nabisco, I guess that would be about it. And us being on our own.
Q. Market changes. What are the market changes?
A. The market changes are I think the ones that -- the changes that have been imposed by the Master Settlement Agreement in terms of how we sell and promote our product and market our product. And also our share decline, which I spoke about immediately prior to the break.

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Q. Anything else?
A. There may be some other things. I don't have them right on the top my tongue right now.

00064

Q. What about structural changes?
A. The structural exchanges would be going from a large holding company of R.J.R. Nabisco down to basically a company that we are today, which is a company that sells only cigarettes in the United States.
Q. Any other changes under structural changes?
A. I can't think of any right now.
Q. Legal development.
A. Where would you like me to start?
Q. What are the legal developments in the past that have made -- I assume you're talking about the recent past -- will have some impact on the company?
A. If you refer to our notes, we've got more than five hundred cases that are pending against us right now. There is a multitude of cases and things that are very challenging to this business. To defend ourselves against those.
Q. Other than the pending cases, or something else you may have already discussed, because you don't have to repeat it.
What would be the legal developments recently that have made -- that have impacted the company?
A. I can't think of any.
Q. What has your total legal defense costs been for all these five hundred cases to date?

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MR. ESCHER: Objection, instruct him not to answer on the basis of attorney-client communications and irrelevance to his opinions in this case.
BY MR. BROWN: Q. I take it you're not going to suggest that legal defense costs are a factor that's impacted the company, then?
A. Well, any dollar that we spend impacts the company, and I can assure you we spend more than a dollar.
MR. BROWN: I don't want to find out what you're paying Joe. But overall can you give me a ball-park area of how significant your legal defense costs are in, say, '99?
MR. ESCHER: I am going to object and instruct you not to answer that question.
MR. BROWN: Joe is not getting most of it; is he?
THE WITNESS: You will have to ask Joe.
MR. ESCHER: I am certainly not.
BY MR. BROWN: Q. Anything else in terms of legal developments that you haven't mentioned?
A. I don't believe so.
Q. Then it says, No. 5, "The impact which serial punitive damage awards will likely have on the company."
What impact do you think serial punitive damages awards will -- keyword -- likely have on the company?
I'm talking about probable, likely.
A. It could affect our bank credit agreement. There

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is a clause in our bank credit agreement, as I believe there are in -- I think it's customary. It's called the material adverse changes clause. The banks -- what were your words? Serial?
Q. Yeah. Your words, actually.
A. There is a material adverse change in the business, and refused to -- or revoked their bank credit

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agreement, which would seriously jeopardize us in terms of our ability to borrow money.

Q. What amount of serial punitive damage awards would you have to reach before it would have a material effect on the company?

A. I think that would depend on probably a lot of factors, and that is, if our volume continues to decline, then an amount probably not very substantial would be -- you know, would affect us.

Q. What do you mean in terms of numbers not very substantial?

A. It would depend upon what our sales decline was and how much our income was affected by these other events.

Q. So it sounds like you have two areas of unknown here that you can't quantify. One is your sales decline, and one is the amount of punitive damages that you may have to pay in the future.

Would that be correct?

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A. No.

Q. What do you expect to have to pay in the future for punitive damages?

A. I don't know.

Q. What do you expect your sales decline will be?

A. That's probably a little bit more predictable. I don't really know. I would expect our sales would continue to decline probably in the range of two to four percent a year, our unit sales.

Q. What about dollars?

A. I'm not even sure about that. That's basically what a historical trend would probably show if you excluded 1999.

Q. And do you expect a decline in dollars, gross sales?

A. During which period?

Q. In the future. At any time.

A. I don't know. I don't know what our pricing will be in the future.

Q. Wouldn't it be correct to say that in terms of impact on serial punitive damages on the company, you don't have an understanding as to the probable amount of those damages, No. 1?

That would be correct; wouldn't it?

A. Right.

00068

Q. And you don't have an understanding as to the probable decline in sales, if any, in dollar sales, if any.

A. I don't have a what?

Q. The corporation hasn't made a judgment as to the probability of declining sales in terms of dollars.

A. I don't have a specific -- I don't think I have I got a specific number on that. I mean, I don't.

Q. Does the corporation have a general idea of whether or not, in terms of dollars, sales will decline in the future?

A. I think it all depends on the ability -- or our ability to increase our prices.

Q. It sounds like it's an unknown.

A. Well, it is.

MR. BROWN: I think that covers it, and I appreciate your time, Mr. Adams. I guess I will get a chance to meet you; right? I hope. I guess you hope not.

MR. ESCHER: Yes, we hope not.

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MR. BROWN: Joe is smiling. Thank you very much. I think that does it.

MR. ESCHER: Neil, I will call you back in a few minutes. Thank you very much.

(The deposition concluded at 11:27 a.m.)

SIGNATURE OF WITNESS

CERTIFICATE OF DEPOSITION OFFICER

I, JO ANN BRUSCELLA, C.S.R. No. 4295, duly authorized to administer oaths pursuant to Section 2093(b) of the Code of Civil Procedure, hereby certify that the witness in the foregoing deposition was by me duly sworn to testify the truth, the whole truth and nothing but the truth in the within-entitled cause; that said deposition was taken at the time and place therein stated; that the testimony of the said witness was reported by me and thereafter transcribed by me or under my direction into typewriting; that the foregoing is a full, complete and true record of said testimony; and that the witness was given an opportunity to read and correct said deposition and to subscribe the same.

I FURTHER CERTIFY that I am not of counsel nor attorney for either or any of the parties in the foregoing deposition and caption named, or in any way interested in the outcome of the cause named in said caption.

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